

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

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In the Matter of)
)
Special Access Rates for Price Cap Local) WC Dkt. No. 05-25
Exchange Carriers)
)

**REPLY COMMENTS OF THE
OFFICE OF ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION,
ON THE NOTICE OF PROPOSED RULEMAKING
AND INITIAL REGULATORY FLEXIBILITY ANALYSIS**

The Office of Advocacy of the U. S. Small Business Administration ("Advocacy") submits these Comments to the Federal Communications Commission ("FCC" or "Commission") regarding the Notice of Proposed Rulemaking ("NPRM" or "proposed rule") in the above-captioned proceeding.¹ The FCC is seeking comment on the regulatory framework applied to interstate special access services for incumbent telecommunications carriers that are regulated under a price cap scheme and whether it should maintain or modify the pricing flexibility rules for special access services.

Advocacy agrees with the FCC's determination that this proposed rule will have a significant economic impact on small wireline carriers. Under the Regulatory Flexibility Act ("RFA"), the FCC must analyze the impacts as well as consider alternatives to minimize the impact on small entities. Accordingly, the FCC should give careful consideration to economic impacts and significant alternatives presented by small entities. To assist the FCC in its analysis, Advocacy has solicited input from small entities, reviewed their recommendations, and prepared

¹ See *Notice of Proposed Rulemaking*, WC Dkt. No. 05-25, FCC 05-18 (rel. January 31, 2006).

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these comments reviewing the impacts and available alternatives.

1. Advocacy Background

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. Advocacy is an independent office within the Small Business Administration ("SBA"), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. Section 612 of the RFA requires Advocacy to monitor agency compliance with the RFA, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996.²

Congress crafted the RFA to ensure that, while accomplishing their intended purposes, regulations did not unduly inhibit the ability of small entities to compete, innovate, or to comply with the regulation.³ To this end, the RFA requires agencies to analyze the economic impact of draft regulations when there is likely to be a significant economic impact on a substantial number of small entities, and to consider regulatory alternatives that will achieve the agency's goal while minimizing the burden on small entities.⁴

On August 13, 2002, President George W. Bush signed Executive Order 13272 requiring federal agencies to implement policies protecting small entities when writing new rules and regulations.⁵ This Executive Order highlights the President's goal of giving "small business owners a voice in the complex and confusing federal regulatory process"⁶ by directing agencies to work closely with the Office of Advocacy and consider properly the impact of their regulations on small entities. Executive Order 13272 also requires agencies to give every

² Pub. L. No. 96-354, 94 Stat. 1164 (1980) (codified at 5 U.S.C. §§ 601-612) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

³ Pub. L. 96-354, FINDINGS AND PURPOSES, SEC. 2 (a)(4)-(5), 126 CONG. REC. S299 (1980).

⁴ See generally, Office of Advocacy, U.S. Small Business Administration, *A Guide for Federal Agencies: How to Comply with the Regulatory Flexibility Act* (2003), available at <http://www.sba.gov/advo/laws/rfaguide.pdf>.

⁵ Exec. Order. No. 13272 at § 1, 67 Fed. Reg. 53,461 (2002).

⁶ White House Home Page, *President Bush's Small Business Agenda*, (announced March 19, 2002) (last viewed February 2, 2004) <<http://www.whitehouse.gov/infocus/smallbusiness/regulatory.html>>.

appropriate consideration to any comments provided by Advocacy. Under the Executive Order, the agency must include, in any explanation or discussion accompanying the final rule's publication in the *Federal Register*, the agency's response to any written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.⁷

2. Proposed Special Access Rules Will Have a Significant Impact on Small Businesses

In compliance with the RFA, the FCC prepared an initial regulatory flexibility analysis ("IRFA") as part of its proposed rules on reexamining the regulatory framework to apply to price cap local exchange carriers special access services.⁸ Special access services are dedicated wires and other facilities that run directly between two customers or between a customer and a telecommunications carrier other than the incumbent carrier. The FCC is considering modifying its rules in response to the expiration of the current regulatory scheme for price cap carriers which was intended to run until June 30, 2005, but now will continue until the FCC adopts a subsequent plan.⁹

In the IRFA, the Commission does a thorough job citing the need for and objectives of the proposed rules, as well as identifying the affected classes of small entities, such as the small incumbent carriers and the small competitive carriers. However, the Commission only discusses the impact of the rules on small incumbent carriers, stating that if it adopts new special access charge rules, it may require additional or modified record keeping from these carriers.¹⁰ The FCC provides no details of potential costs of the impact on small competitive carriers in the

⁷ *Id.* at § 3(c).

⁸ Under the Commission's rules incumbent carriers are historically regulated under a rate-of-return scheme, but carriers may opt to be regulated under a price cap scheme. All of the Bell Operating Companies and some small incumbent carriers (such as Iowa Telecommunications Services) have chosen price cap regulation.

⁹ NPRM paras. 1-2.

¹⁰ *Id.* at 143.

IRFA itself, even though the Commission discusses generally the impact in the body of the proposed rule.

Based upon our conversations with small businesses and review of the comments, Advocacy believes the FCC's proposals regarding special access rates will have an impact on small competitive carriers. We recommend that the FCC consider the costs of such in preparation of its final regulatory flexibility analysis ("FRFA").

The FCC's current rules have a significant economic impact on small competitive carriers and will have a long term effect if the Commission opts to retain them. In the proposed rule, the FCC recognized that markets where large price cap carriers have important assets that are not accessible to potential entrants gives the incumbent "absolute advantage."¹¹ Also, the FCC recognized that special access rates have been increasing in recent years.¹²

As part of the discussion of whether to modify its rules, the FCC states that competitive carriers believe that special access rates are too high¹³ and that incumbent carriers have maintained or raised rates using their market dominance.¹⁴ Competitive carriers reiterated their concerns in the comments, presenting evidence that special access rates have tripled and are excessive.¹⁵ According to one commenter, the larger incumbent carriers are achieving a rate of return of 53.7 percent on average under pricing flexibility, which is significantly higher than

¹¹ *Id.* at 107.

¹² *Id.* at 27 (stating that the interstate special access accounting rates of return for Bell Operating Companies were approximately 38, 40, and 44 percent in 2001, 2002, and 2003 respectively).

¹³ *Id.* at 59.

¹⁴ *Id.* at 70.

¹⁵ Comments of WilTel Communications to the *Notice of Proposed Rulemaking* in WC 05-25 at 20 (June 13, 2005) (WilTel); Comments of ATC Communications Services, Bridgecom International, Broadview Networks, Pac-West Telecomm, US LEC Corp, Telepacific Communications to the *Notice of Proposed Rulemaking* in WC 05-25 at 6-9 (June 13, 2005) (Pac-West et alia); Comments of CompTel/ALTS, Global Crossing North America, NuVox Communications to the *Notice of Proposed Rulemaking* in WC 05-25 at 4 (June 13, 2005) (CompTel/ALTS); Comments of PAETEC Communications to the *Notice of Proposed Rulemaking* in WC 05-25 at 4-5 (June 13, 2005) (PAETEC); Comments of XO Communications to the *Notice of Proposed Rulemaking* in WC 05-25 at 4-5 (June 13, 2005) (XO).

11.25 percent which was the last benchmark for price cap carriers.¹⁶

Since the Commission's decision in the Triennial Review Remand Order ("TRRO") on the availability of unbundled network elements ("UNEs"),¹⁷ competitive carriers must use special access services instead of UNEs in many metropolitan markets. Under the TRRO, switching is no longer available as a UNE and transport and loops are conditioned on having fewer than 38,000 access lines in a wire center.¹⁸ This rule has sharply increased the competitive carriers' reliance on special access, and this number is likely to increase as the TRRO takes further effect and UNEs are phased out in additional markets. Currently, competitive carriers estimate that 15-20 percent of competitive access lines are special access lines.

Because of the increased reliance on special access from the TRRO, use of special access by competitive carriers is changing and is no longer limited to a few big customers but will be commonly used to provide competitive access. The FCC should recognize this change in circumstances and detail the impact that it will have on small competitive carriers in its proposal for comment.

3. Significant Alternatives that Could Minimize the Impact on Small Carriers

While the alternatives section of the IRFA mentions that the FCC is seeking comment on the appropriate price cap special access rate and the components of the rate, it does not list alternatives that would minimize the impact on small business. The Commission discussed several alternatives in the body of the proposed rule, and Advocacy encourages the FCC to consider these alternatives in the preparation of its FRFA.

¹⁶ Comments of the Ad Hoc Telecommunications Users Committee to the *Notice of Proposed Rulemaking* in WC 05-25 at 16 (June 13, 2005) (Ad Hoc).

¹⁷ See *Order on Remand*, WC Dkt. No. 04-313, FCC 04-290 (rel. February 4, 2005).

¹⁸ TRRO para 5.

a. Alternatives to Special Access Pricing Regulation

The FCC proposes a number of alternatives in the text of the rule to address the pricing concerns. Small businesses and other parties supplemented this list in the comments.¹⁹

Advocacy urges the FCC to consider these and other alternatives in the FRFA.

Use a forward-looking model for setting price caps. FCC stated in the proposed rule that forward-looking costs matter for a rational profit-maximizing firm.²⁰ A forward-looking model would require carriers to economize and recognize advancements in technology. In our outreach to small business and in comments already submitted by small business in this rulemaking, competitive carriers strongly supported a forward-looking model, as it would put downward pressure on the price and take into account economies of scale.²¹

Downward Pricing Flexibility. Many competitive carriers favored a proposal called "downward pricing flexibility."²² This allows incumbents to adjust their prices downward without regulation, but they cannot raise it without approval from the FCC. Under this regulatory scheme incumbents could respond to competitive pressures while ensuring that they weren't able to abuse their market power if the market is not competitive. Downward pricing flexibility has the advantage of being self-enforcing while imposing minimal regulatory burdens.

Revisiting Cost Studies. Cost studies were used to establish rate levels for each special access service before the advent of price caps. The FCC proposed an alternative to cost studies that would use the 11.25 percent rate of return that rural carriers currently use.²³ Another alternative proposed by small carriers is to revisit costs studies to establish a new rate of return.²⁴

¹⁹ WilTel Communications at 16; Ad Hoc at 4; CompTel/ALTS at 21-31.

²⁰ NPRM para. 65.

²¹ WilTel at 16-17; Pac-West et alia at 17-22.

²² PAETEC at 13-15; Pac-West et alia at 32-35; CompTel/ALTS at 31.

²³ NPRM para. 64.

²⁴ CompTel/ALTS at 21-28; WilTel at 16-18; Pac-West et alia at 22-24.

Rely on a Surrogate Rate. Competitive carriers recommended basing special access pricing under a new price cap plan that uses the rates in these competitive markets as a proxy.²⁵ The FCC proposed a similar alternative that would set rates for special access at levels equal to current prices for comparable switched access transport prices.²⁶ Since the FCC is attempting to model special access after competitive markets, this would use an actual competitive rate while avoiding the burden of a cost study to set the rate.

Restriction on Bundling. The FCC asked if incumbents should be able to offer non-bundled, product by product discounts.²⁷ This alternative would require carriers to sell each product individually, allowing more opportunity for competitive carriers to make competitive offerings on select services.

Restriction on Previous Purchase Level. The FCC asked if incumbents should be able to condition discounts on previous purchase levels.²⁸ This alternative would restrict incumbent carriers from offering discounts that would bind a customer into purchasing solely from the incumbent and encourage "churn" (customers moving from carrier to carrier).

Restriction on Length of Term Commitments. The FCC asked if incumbents should be able to condition discounts on length of term commitments.²⁹ This alternative would encourage churn in the market and prevent a single carrier from imposing long term contracts on customers.

Restriction on Termination of Carriage with Competitors. The FCC asked if incumbents should be able to condition discounts on terminating service with competitive carriers.³⁰ This alternative would restrict incumbents from giving incentives to customers who bring all their

²⁵ CompTel/ALTS at 25-27.

²⁶ NPRM para. 66.

²⁷ NPRM para. 121.

²⁸ *Id.* at 122.

²⁹ *Id.* at 123.

³⁰ *Id.*

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6. Conclusion

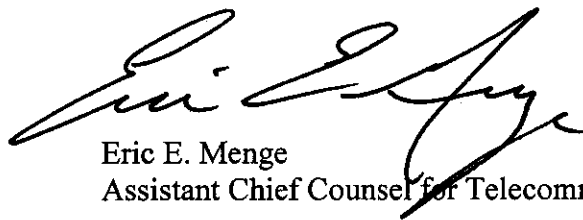
Advocacy urges the FCC to consider the comments from small entities and consider the regulatory impact on small carriers when it prepares its FRFA. Special access pricing will be a significant cost to small competitive carriers and will have a long term impact upon the marketplace and competitive entry. Consideration of the alternatives presented by small carriers could minimize that impact and encourage competitive entry.

The Office of Advocacy is available to assist the Commission in its outreach to small business or in its consideration of the impact on them. We urge the Commission to consult with us in developing the FRFA for the special access pricing final rule. Advocacy has a unique statutory role to play in regard to the RFA, and we can assist the Commission in developing its regulatory flexibility analyses. Please contact me or Eric Menge of my staff at (202) 205-6533 or eric.menge@sba.gov.

Respectfully submitted,



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July 27, 2005

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Certificate of Service

I, Eric E. Menge, an attorney with the Office of Advocacy, U.S. Small Business Administration, certify that I have, on this 27th day of July 2005, caused to be mailed, first-class, postage prepaid, a copy of the foregoing Comments to the following:



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